UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

IN RE		MEMORANDUM & ORDER
BANK OF NEW YORK DERIVATIVE LITIGATION	:	99 Civ. 9977 (DC) 99 Civ. 10616 (DC)

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CHIN, D.J.

In these consolidated derivative actions brought on behalf of shareholders of the nominal defendants Bank of New York Company, Inc. (the "Company") and its wholly-owned subsidiary, the Bank of New York (the "Bank"), plaintiffs contend that the individual defendants, nineteen former or current officers and directors of the nominal defendants, breached their fiduciary

duties to the shareholders by wrongfully permitting the Bank to aggressively expand its correspondent banking business in Russia. Plaintiffs charge that the individual defendants directly participated in, or knowingly or recklessly permitted the Bank to participate in, money laundering or other illegal activity with customers, including members of organized crime.

Defendants move to dismiss the Amended Verified Shareholder Derivative Complaint (the "Amended Complaint") on the grounds that plaintiffs failed to make a demand on the Board of Directors of either the Company or the Bank prior to filing suit, as required by section 626(a) of the New York Business Corporation Law. Alternatively, noting that the Boards of the Company and the Bank have formed a Special Litigation Committee (the "SLC") to investigate the shareholder derivative claims, defendants move for a stay of this action pending the investigation. Defendants advise that if the SLC determines that the derivative claims lack merit, they will ask this Court to dismiss the action.

For the reasons that follow, both prongs of the motion are denied.

DISCUSSION

A. The Motion To Dismiss

1. Applicable Law

The parties agree that New York law governs. Under New York law, because derivative claims against a corporation's

officers and directors belong to the corporation itself, section 626 of the Business Corporation Law requires a shareholder to first demand that the corporation initiate the lawsuit itself. See generally Marx v. Akers, 644 N.Y.S.2d 121, 123-24 (1996). The requirement of a demand on the board is excused, however, if the demand would be futile. Id.; see N.Y. Bus. Corp. Law § 626(c) (McKinney 1986).

In Marx, the Court set forth New York's "approach" to demand futility:

> a demand would be futile if a complaint alleges with particularity that (1) a majority of the directors are interested in the transaction, or (2) the directors failed to inform themselves to a degree reasonably necessary about the transaction, or (3) the directors failed to exercise their business judgment in approving the transaction.

644 N.Y.S.2d at 126. As defendants point out, demand futility is not sufficiently alleged "merely" by naming a majority of the directors as defendants with "conclusory allegations of wrongdoing or control by wrongdoers." Id. at 127 (quoting Barr v. Wackman, 368 N.Y.S.2d 497, 506 (1975)). Instead, as section 626(c) specifically requires, the complaint "shall set forth with particularity the . . . reasons for not making" a demand.

2. Application

Here, the Amended Complaint alleges demand futility with the requisite particularity. Indeed, the Amended Complaint devotes approximately five pages to explaining why a demand on the boards of the nominal defendants would have been futile.

(Am. Compl. ¶¶ 190-201). In addition to the five pages devoted specifically to demand futility, the Amended Complaint contains numerous other specific allegations addressing the individual defendants' involvement and/or failures.

Tracking the applicable language from Marx, the Amended Complaint alleges, for example, that, in approving certain actions by the Bank, at least eleven of the individual defendants "failed to fully inform themselves to the extent reasonably appropriate under the circumstances." (Am. Compl. ¶ 193). See Marx, 644 N.Y.S.2d at 128 ("Demand is excused because of futility when a complaint alleges with particularity that the [directors] did not fully inform themselves about the challenged transaction to the extent reasonably appropriate under the circumstances."). Moreover, the Amended Complaint does not stop there, but provides detailed allegations. For example, it charges that the individual defendants "ignored the clear risks of doing substantial wire transfer and other similar business with Russian correspondent banks," "failed to adopt reasonable internal controls and independent monitoring systems over [the Bank's] wire transfer business," and "ignored repeated specific warnings that [the Bank's] system of internal controls over its wire transfer business was a sham and that [the Bank] was aiding or participating in its customers' illegal banking activity." (Am. Compl. ¶ 191).

In addition, the Amended Complaint provides numerous specific examples of publicly available and other information

that plaintiffs contend should have put the individual defendants on notice, had they been acting with the diligence required of officers and directors of a bank, that the Bank was being exposed to unacceptable risks. (See, e.g., id. at ¶¶ 9, 74, 78, 139, 141, 164, 197, 199). See, e.g., Miller v. Schreyer, 683 N.Y.S.2d 51, 55 (1st Dep't 1999) (adhering to decision that demand was futile on basis that complaint alleged that corporate directors had unreasonably failed to inform themselves, when complaint alleged that "illegal purpose of the transactions, their magnitude and duration, [and] their timing" should have brought matter to attention of "senior management even on a rudimentary audit," and noting that it was not "naive to consider it futile to expect the directors to launch a vigorous investigation well after the facts have come to light") (applying New York law but considering Delaware law as well). The Amended Complaint alleges that one of the officer defendants directly participated in illegal schemes and that other individual defendants "approved the restructuring of [the Bank's] European Division, the creation of an Eastern European Division, and/or [the Bank's] subsequent rapid and unchecked expansion into the Russian banking market," in the process "ignor[ing] multiple, specific warnings . . . that the Russian banking system was being infiltrated by organized crime." (Id. at ¶¶ 192, 193). See In re Oxford Health Plans, Inc. Sec. Litig., 192 F.R.D. 111, 114-15 (S.D.N.Y. 2000) ("In numerous cases where liability is based upon a failure to supervise and monitor, and to keep adequate supervisory controls

in place, demand futility is ordinarily found, especially where the failure involves a scheme of significant magnitude and duration which went undiscovered by the directors.") (applying Delaware law).

Accordingly, I hold that the Amended Complaint alleges with sufficient "particularity" the reasons plaintiffs did not make a demand upon the boards. The motion to dismiss is denied.

B. The Motion For A Stay

1. Applicable Law

In shareholder derivative cases, the New York courts have held that where a demand on the board of directors is excused on grounds of futility, the board may delegate the decision of whether to pursue the claims to a committee of disinterested, independent directors. See, e.g., Auerbach v. Bennett, 419 N.Y.S.2d 920, 927 (1979); see also Strougo v. Bassini, 112 F. Supp. 2d 355, 361 (S.D.N.Y. 2000) ("A special litigation committee has the power to terminate a derivative action to the extent allowed by the state of incorporation.") (applying Maryland law). In Auerbach, the New York State Court of Appeals held that the "substantive aspects" of a special litigation committee's decision to terminate a shareholder derivative suit are "beyond judicial inquiry under the business judgment doctrine," and that therefore courts may inquire only as to the "disinterested independence of the members of [the] committee and as to the appropriateness and sufficiency of the investigative procedures chosen and pursued." Id. at 922. See

generally Kamen v. Kemper Fin. Serv., Inc., 500 U.S. 90, 102 (1991) (discussing New York law on special litigation committees).

Courts have discretion to stay discovery of a derivative suit pending a special litigation committee's decision on whether the corporation should pursue the claims against the officers and directors. See, e.g., Strougos v. Padegs, 986 F. Supp. 812, 815 (S.D.N.Y. 1997) (observing that "courts normally grant a stay of proceedings for a reasonable period to permit an SLC to complete its investigation"); Lichtenberg v. Zinn, 663 N.Y.S.2d 452, 454 (3d Dep't 1997) (holding trial court did not abuse its discretion in refusing director defendants' request to limit discovery pending special litigation committee's report).

2. Application

Defendants' request for a stay in this case is denied, for the following reasons.

First, this case has already been pending for more than a year, and a stay of the case at this juncture will only delay matters. Early on in the case the parties agreed to delay formal discovery as they engaged in informal discovery, joint investigation, and "exploration" of the issues. Defendants could have created the SLC a year ago, but waited until September 12, 2000 to do so. The delay weighs against staying these proceedings now.

Second, discovery is proceeding in the parallel state action, Katz v. Renyi, No. 604465/99, pending in the Supreme

Court, New York County. This fact weighs against staying the proceedings in the instant case.

Third, substantial questions exist as to whether the members of the SLC are truly independent and disinterested. Although three directors were originally appointed, one has already resigned because of a potential conflict of interest. The remaining two members are named defendants in this case and both began serving as board members, according to plaintiffs, prior to the commencement of these lawsuits. The members of the SLC have joined in the instant motion, in which they and the other defendants have strenuously denied any wrongdoing; it is difficult to imagine that the SLC will reach any conclusion other than that the complaint lacks merit and therefore should be withdrawn. See Auerbach, 419 N.Y.S.2d at 927 (special litigation committee must be composed of independent directors who "possess a disinterested independence and do not stand in a dual relation which prevents an unprejudicial exercise of judgment").[1]

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[1] As the Second Circuit has observed:

> The reality is . . . that special litigation committees created to evaluate the merits of certain litigation are appointed by the defendants to that litigation. It is not cynical to expect that such committees will tend to view derivative actions against the other directors with skepticism. Indeed, if the involved directors expected any result other than a recommendation of termination at least as to them, they would probably never establish the committee.

Joy v. North, 692 F.2d 880, 888 (2d Cir. 1982) (applying Connecticut law).

Accordingly, further delay for the SLC to investigate matter is not warranted.

CONCLUSION

Defendants' motion to dismiss is denied, as is their alternative request for a stay of these proceedings.

SO ORDERED.

Dated: New York, New York
November 13, 2000

DENNY CHIN
United States District Judge

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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BANK OF NEW YORK DERIVATIVE LITIGATION	:	99 Civ. 9977 (DC) 99 Civ. 10616 (DC)

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CHIN, D.J.

Defendants move for reconsideration of that part of my decision of November 14, 2000 denying their request for a stay of this action pending the completion of an investigation by a Special Litigation Committee ("SLC") appointed by the Bank into the merits of the derivative claims asserted in the Amended Verified Shareholder Derivative Complaint. See In re Bank of New York Derivative Litigation, No. 99 Civ. 9977 (DC), 2000 WL 1708173 (S.D.N.Y. Nov. 14, 2000). The motion for reconsideration is denied, for the reasons set forth in my November 14th decision. I add the following:

1. Defendants argue that I failed to mention or apply the rule set forth in Strougo v. Padegs, 986 F. Supp. 812, 815 (S.D.N.Y. 1997), to the effect that a stay pending completion of an SLC investigation should be denied only in "extraordinary" circumstances. Strougo, however, is not controlling, as the Court there applied Maryland law. The Court did not cite any New York cases.

The New York courts have not specifically addressed the question of what standard a court should apply in deciding

whether to stay a derivative case pending an SLC investigation. In Lichtenberg v. Zinn, 663 N.Y.S.2d 452, 454 (3d Dep't 1997), the court applied an abuse of discretion standard in reviewing the trial court's decision not to limit discovery to the areas of the disinterested independence and good faith of SLC members, as the defendants had requested. The Third Department affirmed -- without any discussion of whether "extraordinary" circumstances had been demonstrated. See id. The Third Department's failure to discuss the "extraordinary" circumstances standard certainly suggests that the Third Department did not believe the standard applies.

The decision of the New York Court of Appeals in Parkoff v. Gen. Tel. & Electronics Corp., 442 N.Y.S.2d 432 (1981), also supports the conclusion that the decision to issue a stay of a derivative case pending completion of an SLC investigation is a matter committed to the trial court's discretion. There, the court quoted from the Second Department's decision in Auerbach with approval:

> The business judgment doctrine should not be interpreted to stifle legitimate scrutiny by stockholders of decisions of management which, concededly, require investigation by outside directors and present ostensible situations of conflict of interest. Nor should the report of the outside directors be immune from scrutiny by an interpretation of the doctrine which compels the acceptance of the findings of the report on their face. In particular, summary judgment which ends a derivative action at the threshold, before the plaintiff has been afforded the opportunity of pretrial discovery and examination before trial, should not be the means of foreclosing a nonfrivolous action.

Id. at 434-35 (quoting Auerbach v. Bennett, 408 N.Y.S.2d 83, 88 (2d Dep't 1978), modified, 419 N.Y.S.2d 920 (1979)). The court's observation that the business judgment rule should not be used to foreclose a nonfrivolous derivative case before the plaintiff has had an opportunity for discovery suggests that "extraordinary" circumstances need not exist for discovery to go forward.

2. Even assuming "extraordinary" circumstances must be shown, I conclude that plaintiffs have made such a showing in this case.

The action is a nonfrivolous one that raises serious issues, and both sides have invested a great deal of time and resources into the case already. Plaintiffs are represented by experienced, capable counsel who have supported the substantial charges set forth in the amended complaint with detailed factual allegations. The case has been pending for more than a year. Defendants could have appointed an SLC months ago, but they waited until now. The SLC investigation is predicted to take approximately six months. Defendants' vehement denials of wrongdoing and the fact that the two remaining members of the SLC are defendants in this action suggest that the SLC is likely to conclude at the end of its investigation that the action should be dismissed. Defendants will undoubtedly move to dismiss at that point. Briefing, discovery on the issues of disinterested independence and good faith, and a decision on the motion would undoubtedly take many more months. Only then, some two years after the filing of the action, would plaintiffs be able to

formally conduct discovery on the merits (assuming the motion to dismiss is denied). Such a delay is not justified, and under all the circumstances of this case, plaintiffs will be permitted to proceed with discovery at this time.

CONCLUSION

Defendants' motion for reconsideration is denied.

SO ORDERED.

Dated: New York, New York
December 13, 2000

DENNY CHIN
United States District Judge